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FEDERAL COMMUNICATIONS COMMISSION
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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992	)	MM Docket No. 93-215
	)	
Rate Regulation	)	
	)	
and	)	
	)	
Adoption of a Uniform Accounting System for Provision of Regulated Cable Service	)	CS Docket No. 94-28

REPLY OF THE JOINT PARTIES

Cablevision Industries Corporation ("CVI") and Jones Intercable, Inc. (the "Joint Parties"), by their attorneys, hereby respond to certain oppositions to petitions for reconsideration filed in the above-referenced matter. The public interest is not served by rules that fail to account for the financial realities faced by cable operators and retroactively penalize operators for investments that occurred prior to regulation. The Commission must reject those oppositions that seek to impose unjustified regulatory burdens on cable operators and adopt rules that reflect the economic fundamentals of the cable industry. While the solutions proposed by Continental Cablevision, *et al.* ("Continental") and the United States Telephone Association ("USTA") are superior to the rules adopted by the Commission, the Joint Parties believe that full recovery of and return on pre-regulation investment in tangible and intangible assets is necessary to satisfy constitutional standards.

I. THE COMMISSION SHOULD IMMEDIATELY ADOPT A WORKABLE MECHANISM TO PERMIT OPERATORS TO RECOVER AND EARN A RETURN ON PRE-REGULATION INVESTMENTS

The comments demonstrate that the Commission's treatment of intangible assets and net operating losses of a cable operator are administratively burdensome and may produce results that are confiscatory.[1/] As stated by USTA, "this set of presumptions is ambiguous, complex and probably unworkable in local rate setting proceedings." Response of USTA at 10. To satisfy constitutional standards (and avoid a plethora of filings for hardship relief), the Commission must amend its rules to include a transition mechanism that permits operators to recover and earn a fair return on their pre-regulation investments in

1/ NATOA, however, argues that there is "no reason whatsoever" for including intangible assets in the ratebase. As discussed below, if this unyielding interpretation of the presumptions adopted by the Commission is pursued by local regulators it will result in: (i) needless litigation over requests for stays of all local cost of service decisions; and (ii) some cable companies being unable to pay debt incurred prior to regulation. Bell Atlantic opposes inclusion of "excess acquisition costs" and states that this investment should be recovered from unregulated services, the result is that unregulated services subsidize regulated services. It is ironic that Bell Atlantic and other LECs continually argue that they are unfairly required to subsidize residential service with revenues from other services even as they advocate that regulated cable service should be subsidized by unregulated services.

tangible and intangible assets (including the stepped-up basis of tangible assets) and net operating losses.[2/]

Continental proposes that operators be permitted to include 66 percent of the gross purchase price of an acquired system in the ratebase. Response of Continental at 6. Continental also proposes that accumulated losses from early years of operation should be treated as additional investment in the system and added to the ratebase. *Id.* at 8. USTA suggests that operators be permitted to amortize, but not earn a return on, their pre-regulation investment in acquired intangible assets.[3/]

The proposals advanced by Continental and USTA are superior to the current rules, but both proposals understate the return that operators should

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2/ Bell Atlantic's statement that exclusion of pre-regulation investments is "standard regulatory practice" is grossly misleading. Bell Atlantic cites its Joint Reply Comments "and cases cited therein" to support this proposition. However, the only case cited in the Joint Reply Comments is an FCC decision regarding the ratebase of dominant telephone companies and the potential for abuse presented by the "acquisition by one *utility* of the property of another *utility*." *Amendment of Part 65 of the Commission's Rules to Prescribe Components of the Rate Base and Net Income of Dominant Carriers*, 3 FCC Rcd 269, 273 (1987) (emphasis added). At no point in this proceeding has Bell Atlantic cited any precedent from any regulated field that supports the notion that it is "standard practice" to deny retroactively recovery of and return on investments made before a company becomes regulated as a utility.

3/ Response of USTA at 10-12. As discussed below, the Commission must reject the notion that a transition mechanism (or any other component of the cost of service rules) should be structured to achieve regulatory parity between cable operators and LECs. Moreover, to the extent USTA seeks to deny recovery of "excess acquisition premiums", the Commission should impose the burden of proving such premiums on the regulatory body that reviews a cost of service showing.

be allowed to earn. The USTA proposal, for example, is the equivalent of allowing cable operators to receive only the principal on their debt with no provision for interest. This approach would leave little or no room for any return on equity. Similarly, the Continental approach is unsatisfactory when a 66 percent return on the gross purchase price is insufficient to cover the debt associated with the acquisition. Furthermore, the 34 percent disallowance should be applied only to intangible assets, not to the total purchase price of the system.

The Joint Parties submit that the approach advocated by CVI in its Petition is superior to the proposals advanced by USTA and Continental. Petition of CVI at 12. The Commission must respect the financing arrangements upon which the growth of the cable industry has been based. Prior to regulation lenders relied on the value of *all* the assets of an acquired system, and they demand a return on their *entire* investment notwithstanding the regulatory regime imposed by the Commission. Operators must be permitted to recover their investment in and earn a return on the stepped-up basis of acquired tangible assets, intangible assets and net operating losses.

This position recognizes the importance of intangible assets to all businesses and, more importantly, ensures that operators will earn revenue sufficient to make debt payments that were lawfully incurred prior to regulation. To prevent rate shock if increases are warranted, CVI suggested that recovery of an operator's investment in intangible assets could take place over a reasonable period of time. Petition of CVI at 15 n.14. Thus, the approach advocated by CVI strikes the proper balance between the interests of consumers in rates that are reasonable and operators in rates sufficient to earn a reasonable return and attract capital.

II. THE COMMISSION SHOULD GRANT A BLANKET STAY OF ALL LOCAL COST OF SERVICE DECISIONS PENDING RECONSIDERATION

Regulators often permit rate increases to go into effect subject to an accounting order while the resolution of a rate case is pending. This allows service providers to charge compensatory rates while protecting subscribers if those rates are ultimately held to be unreasonable.[4/] For the same reason, as stated in CVI's Petition, the Joint Parties believe that all local orders prescribing rate *reductions* should be stayed pending appeal. Petition of CVI at 15 n.13.

The Commission's presumptions regarding intangible assets make it likely that operators filing cost of service showings will be ordered to take rate reductions of such magnitude as to make payment of debt impossible and create an environment in which it will be unlikely or impossible to attract capital.[5/] Moreover, NATOA and its members apparently have no inclination to permit a

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4/ *See, e.g., Transcontinental Gas Pipe Line Corp. v. F.E.R.C.*, 866 F.2d 477, 481 (D.C. Cir. 1988); *Papago Tribal Utility Authority v. F.E.R.C.*, 628 F.2d 235 (D.C. Cir. 1980), *cert. denied*, 449 U.S. 1061 (1980).

5/ This result would be inconsistent with the Commission's finding that access to capital is vital to continued innovation and investment. *See* Second Order on Reconsideration, Fourth Report and Order and Fifth Notice of Proposed Rulemaking, MM Docket No. 92-266, FCC 94-38 at ¶ 55 (rel. Mar. 30, 1994).

return on or recovery of intangible assets regardless of the results such a policy would produce.[6] Because of the harsh results the cost of service rules will produce, most operators can be expected to appeal local cost of service decisions to the Commission.

Under the cost of service rules, local authorities have no obligation to stay rate reductions while an appeal of a local rate decision to the Commission is pending. Because of the time required for an appeal (the Commission has not yet decided a single cable programming complaint or appeal of a local rate case) and the magnitude of potential rate reductions, failure to obtain a stay could seriously threaten the viability of a system, or of a cable company.

To spare all parties the needless expense of litigating the inevitable stay requests that will arise under the cost of service rules, the Commission should follow the recommendation contained in CVI's Petition and immediately impose a blanket stay, and corresponding accounting order, on all local enforcement decisions until the Commission adopts a transition mechanism that permits recovery of and return on pre-regulation investments, inclusive of tangible assets, intangible assets and net operating losses.

6/ "[T]here is no reason whatsoever for cable subscribers to pay higher rates to allow an operator to recover such intangible costs." Opposition of NATOA at 7.

III. THE GOAL OF COST OF SERVICE RULES SHOULD BE TO BALANCE CONSUMER AND OPERATOR INTERESTS, NOT TO ACHIEVE REGULATORY PARITY

CVI and other cable operators requested that the Commission reconsider its decision to adopt a rate of return for cable operators equal to the rate used for telephone companies. Petition of CVI at 13 n.11; Comcast at 18. These parties showed that the Commission did not adequately consider the business risks faced by cable operators (including the risks created by the Commission's implementation of the 1992 Cable Act) and that imposing the rate of return established for telephone companies is arbitrary and capricious.[7]

In response, Bell Atlantic, GTE and USTA argue that telephone companies and cable companies must be subject to symmetrical regulatory regimes, including similar rates of return. Response of USTA at 13; Opposition of Bell Atlantic at 3-4; Comments of GTE at 9. The telephone companies have raised this argument repeatedly over the last two years and it has been rejected

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7/ The charge that LECs are subject to greater risk from competition than cable operators is ludicrous. USTA's statement that "neither technical nor regulatory barriers stand in the way of cable companies competing with local exchange carriers" is so far off base that it barely merits a response. Facilities-based telecommunications competition is likely to develop at a slower than expected rate now that federal interconnection rules have been struck down and legal barriers to entry still prohibit local exchange competition in all but a handful of markets. Bell Atlantic, on the other hand, has applications pending to provide video dialtone service to over 3 million subscribers throughout its service area and it is not presently constrained by the telco/cable cross-ownership prohibition.

repeatedly.[8/] The telephone companies once again are attempting to transform a proceeding on cable issues into a forum for their incessant complaints about the price cap rules for local exchange carriers. To the extent new issues are raised by the telephone companies, these issues should be addressed in the *LEC Price Cap Review*[9/] and have no place in this proceeding.[10/]

Not only is the regulatory parity argument advanced by the telephone companies out of place in this proceeding, it is bad public policy. The Commission has correctly recognized that it only should pursue the goal of parity for similarly situated companies in the same market. To suggest that companies in different markets should be subject to regulatory parity because those markets may converge in the future is absurd.[11/]

8/ "Telephone companies have failed to advance a sufficient reason why we should adopt as an overriding policy goal achieving regulatory parity." First Order on Reconsideration in MM Docket No. 92-266. FCC 93-428 at ¶ 90 (rel. Aug. 27, 1993); *see also* Opposition of the National Cable Television Association at 5 n.5 (listing seven pleadings in which Bell Atlantic has requested regulatory parity since January 1993).

9/ *Price Cap Performance Review for Local Exchange Carriers*, Notice of Proposed Rulemaking, 9 FCC Rcd ___ (1994).

10/ Furthermore, the telephone companies want "parity" only for regulations they perceive to place a greater burden on LECs than on cable operators. They are conspicuously silent with regard to burdens placed on cable operators but not on LECs. Response of Continental at 15 n.31. Bell Atlantic, in fact, has vigorously opposed imposition of *any* cable obligations, including franchising, on its video programming operations. *See* Opposition of Chesapeake and Potomac Telephone Co. of Virginia, W-P-C 6834, filed Jan. 10, 1994 at 11-14.

11/ As demonstrated by Discovery Communications, complete regulatory parity also would undermine the Commission's goal of fostering quality programming at reasonable rates. Opposition of Discovery Communications at 3.

IV. CONCLUSION

The Commission should adopt a transition mechanism to permit operators to recover and earn a return on pre-regulation investments. The rate of return on these investments should be based on the realities of the cable industry, not on baseless requests for regulatory parity. Until the Commission adopts these changes, it should impose a blanket stay on all local cost of service decisions that are based on the exclusion from the ratebase of pre-regulation investment in tangible and intangible assets and net operating losses.

Respectfully submitted,

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